STATE BOARD OF EQUALIZATION

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June 7, 1991

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Dear --- ---:

This is in response to your letter dated April 25, 1991, which requests a ruling as to the application of sales tax to the proposed business of your client, who is not identified. Initially, I note that Revenue and Taxation Code section 6596 provides the only basis for relief from tax if a taxpayer relies on incorrect written advice from this Board. The primary conditions to qualify are that the request for opinion must be in writing and must disclose all relevant facts, including the identity of the taxpayer. Since you have not identified your client, this opinion does not come within the provisions of section 5696 but rather is simply general advice regarding a set of hypothetical facts.

You call your client --- who has acquired rights to an electronic data system. You state:

"The system consists of a database and specifically designed application software. The database may not be accessed by any other software. The database is a collection of information relevant to a specific industry. The application software was engineered so that it only can be used with the database provided.

"The system has been modified to allow for the accumulating, summarizing and reporting of information in a more meaningful fashion to potential U.S. users. Further additional fields and sorting capabilities will be added in order to enhance the use of the system in the U.S. Finally, new utility systems were also developed because of the needs of the U.S. Market.

"It is the intention of --- to begin marketing subscriptions to the system as well as providing services as soon as practical. The system will (not) and cannot be sold by ---, since --- does not own the system. A physical copy (on diskette) of the current database and all application software will be issued to subscribers upon notice of acceptance of the subscription agreement. The subscriber will manipulate the data on its computer hardware using the application software provided by ---. If a user decides to cease subscribing, the user will be required to immediately return the database and all utility materials.

"The database will be updated weekly. The updated database and any new modifications to the system will be sent to all subscribers weekly."

You believe that the proposed transactions should be exempt from California sales and use tax based on your belief that the system qualifies as a custom program. I assume your questions relate to the transactions between --- and its subscribers and not between the software developer and ---.

As you note, custom computer programming is defined in subdivision (b) of Regulation 1502. It is defined as a program prepared to the special order of the customer. That is, a custom computer program is one that does not exist at the time the parties enter into the contract since the program cannot be prepared to the special order of the customer if it is already prepared.

My understanding of your description of these transactions is that --- obtains software along with a license to sell copies of that software. Copies of existing software can <u>never</u> constitute custom computer programming. Rather, as defined by subdivision (b) of Regulation 1502, that software constitutes a prewritten program since it is a "program held or existing for general or repeated sale or lease." We conclude that the software transferred from --- to its subscribers does not constitute custom computer programming.

We also disagree with your assertion that the software cannot be sold by --- since --- does not own it. --- has apparently acquired the right to transfer copies of the software. If the subscriber is not required to return those copies to ---, then --- is selling the storage media upon which the software is written. (Rev. & Tax. Code § 6006.) That sale would be subject to sales tax. (Rev. & Tax. Code § 6051.) If the subscriber is required to return the storage media, then --- is leasing that storage media to the subscriber. (Rev. & Tax. Code § 6006.3.). --- presumably would acquire blank storage media upon which to copy the program and would then lease that storage media to the customer. The copying of a program onto storage media is a substantial change, and that storage media would not be leased in substantially the form as acquired. Therefore, the lease is defined as a continuing sale and purchase, (Rev. & Tax. Code §§ 6006 (g) (5), 6006.1, 6010 (e)(5), 6010.0.) That continuing sale and purchase is subject to use tax measured by rentals payable which ---, as the lessor, must collect from the lessee and pay to the state. (Rev. & Tax. Code § 6201, Reg. 1660, a copy of which is enclosed.)

      In summary, --- has obtained the right to transfer copies of software provided to it by the developer. Regardless of how the parties characterize that transfer (e.g., license, sublicense, subscription), that transfer is either an outright sale subject to sales tax or a lease constituting a continuing sale subject to use tax.

      If you have further questions, feel free to write again.

      Sincerely,

      David H. Levine
      Senior Tax Counsel

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Enclosure